

Department of Employment Security

**For the Year Ended
June 30, 1998**

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Editor

March 17, 1999

The Honorable Don Sundquist, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
The Honorable Hazel Albert, Commissioner
Department of Employment Security
Twelfth Floor, Davy Crockett Tower
Nashville, Tennessee 37243

Ladies and Gentlemen:

We have conducted a financial and compliance audit of selected programs and activities of the Department of Employment Security for the year ended June 30, 1998.

We conducted our audit in accordance with generally accepted auditing standards and the standards contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. These standards require that we obtain an understanding of management controls relevant to the audit and that we design the audit to provide reasonable assurance of the department's compliance with the provisions of laws, regulations, contracts, and grants significant to the audit. Management of the Department of Employment Security is responsible for establishing and maintaining internal control and for complying with applicable laws and regulations.

Our audit disclosed a finding which is detailed in the Objectives, Methodologies, and Conclusions section of this report. The department's administration has responded to the audit finding; we have included the response following the finding. We will follow up the audit to examine the application of the procedures instituted because of the audit finding.

We have reported other less significant matters involving the department's internal control and/or instances of noncompliance to the Department of Employment Security's management in a separate letter.

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/ms
99/124

State of Tennessee

Audit Highlights

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit
Department of Employment Security
For the Year Ended June 30, 1998

AUDIT SCOPE

We have audited the Department of Employment Security for the period July 1, 1997, through June 30, 1998. Our audit scope included those areas material to the Tennessee Comprehensive Annual Financial Report for the year ended June 30, 1998, and the Tennessee Single Audit Report for the same period. In addition to those areas, our primary focus was on management's controls and compliance with policies, procedures, laws, and regulations in the areas of payroll, interstate benefits receivable, employer tax receivable, benefit overpayment receivable, revenue, unemployment tax, unemployment benefits, and utilization of the Department of Finance and Administration's STARS grant module to record the receipt and expenditure of federal funds. The audit was conducted in accordance with generally accepted auditing standards and the standards contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

AUDIT FINDING

The Department Did Not Comply With Cash Management Objectives

The department did not minimize the amount of time between drawing and disbursing federal funds. Although the department complied with the method of drawing and receiving funds specified in the state's cash management agreement, it did not disburse timely all of the funds received. As a result, the department had accumulated unspent federal funds of \$5,614,690.50 at June 30, 1998.

"Audit Highlights" is a summary of the audit report. To obtain the complete audit report which contains all findings, recommendations, and management comments, please contact

Comptroller of the Treasury, Division of State Audit
1500 James K. Polk Building, Nashville, TN 37243-0264
(615) 741-3697

Audit Report
Department of Employment Security
For the Year Ended June 30, 1998

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Department of Employment Security For the Year Ended June 30, 1998

INTRODUCTION

POST-AUDIT AUTHORITY

This is the report on the financial and compliance audit of the Department of Employment Security. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated*, which authorizes the Department of Audit to “perform currently a post-audit of all accounts and other financial records of the state government, and of any department, institution, office, or agency thereof in accordance with generally accepted auditing standards and in accordance with such procedures as may be established by the comptroller.”

Section 8-4-109, *Tennessee Code Annotated*, authorizes the Comptroller of the Treasury to audit any books and records of any governmental entity that handles public funds when the Comptroller considers an audit to be necessary or appropriate.

BACKGROUND

The mission of the Department of Employment Security is to enhance the quality of life in Tennessee by providing responsive job referrals to employers; productive client counseling services; an impartially administered, sound, and competitive unemployment insurance program; and reliable and relevant data to foster job development for Tennesseans.

In order to fulfill this mission, the department has four primary sections: Unemployment Insurance, Employment Service, Administration, and Field Operations.

Unemployment Insurance is a joint federal and state program that provides benefits to unemployed workers who lose their jobs through no fault of their own. Unemployment Insurance benefits are paid from the Tennessee Unemployment Insurance Trust Fund. This fund is used only to pay benefits to Tennessee’s unemployed, and the fund is financed entirely by Tennessee employers.

Employment Services provides counseling, training, and job development services to applicants to enhance their employability. Employment Service also provides employers services such as job listings over the phone, pre-screening of applicants, pre-testing of clerical personnel, aptitude testing, on-site screening, and computerized job listings.

The department is also responsible for compiling Tennessee employment data. Information provided includes employment and unemployment data by county; jobs by industry; wages of

selected occupations for various regions of the state; future trends in occupations and industries; population and demographic data; per capita income data; and affirmative action data.

An organization chart of the department is on the following page.

AUDIT SCOPE

We have audited the Department of Employment Security for the period July 1, 1997, through June 30, 1998. Our audit scope included those areas material to the Tennessee Comprehensive Annual Financial Report for the year ended June 30, 1998, and to the Tennessee Single Audit Report for the same period. In addition to those areas, our primary focus was on management's controls and compliance with policies, procedures, laws, and regulations in the areas of payroll, interstate benefits receivable, employer tax receivable, benefit overpayment receivable, revenue, unemployment tax, unemployment benefits, and utilization of the Department of Finance and Administration's STARS grant module to record the receipt and expenditure of federal funds. The audit was conducted in accordance with generally accepted auditing standards and the standards contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

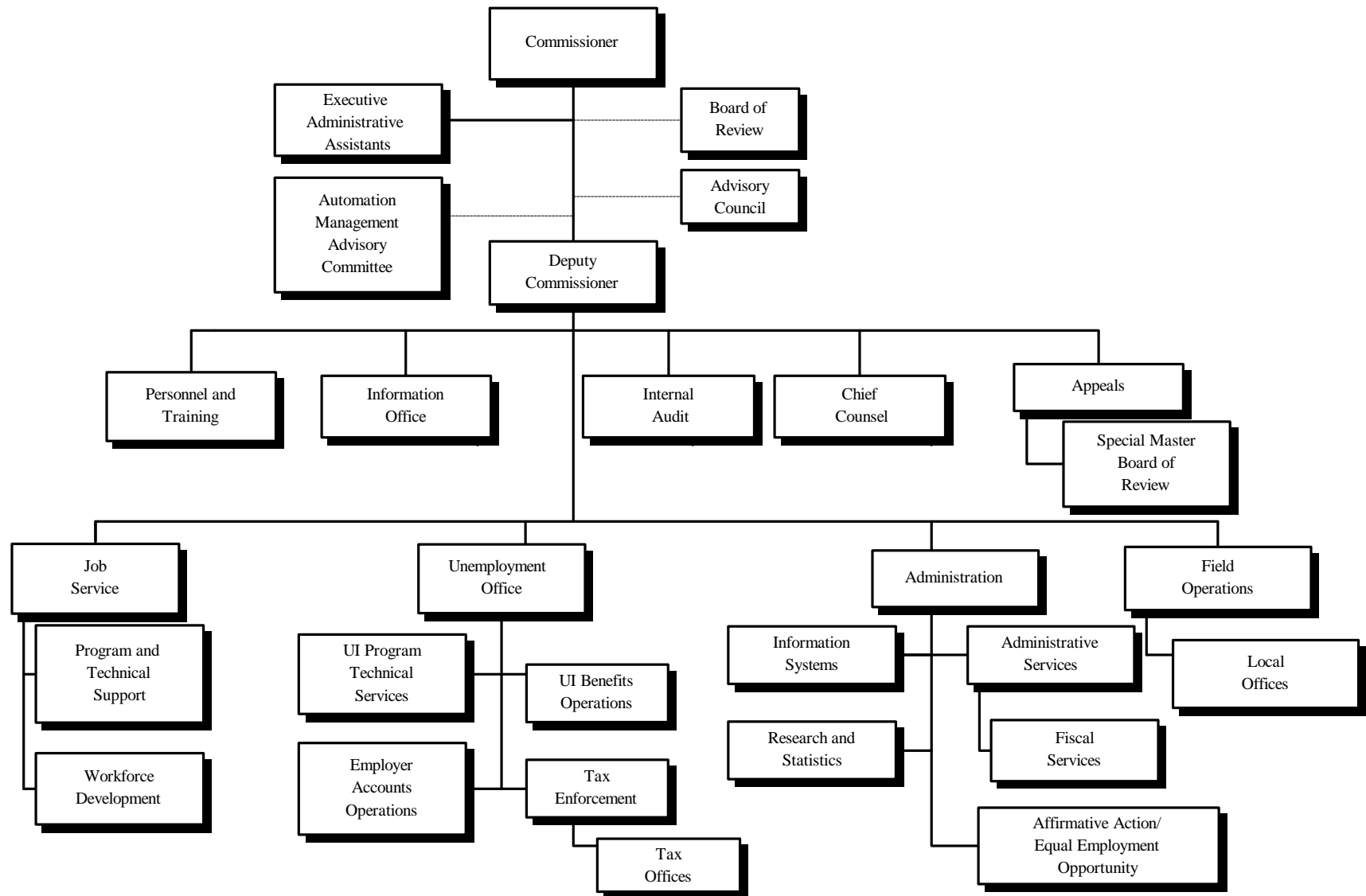
OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

AREAS RELATED TO TENNESSEE'S COMPREHENSIVE ANNUAL FINANCIAL REPORT AND SINGLE AUDIT REPORT

Our audit of the Department of Employment Security is an integral part of our annual audit of the Comprehensive Annual Financial Report (CAFR). The objective of the audit of the CAFR is to render an opinion on the State of Tennessee's general-purpose financial statements. As part of our audit of the CAFR, we are required to gain an understanding of the state's internal control and determine whether the state complied with laws and regulations that have a material effect on the state's general-purpose financial statements.

Our audit of the Department of Employment Security is also an integral part of the Tennessee Single Audit which is conducted in accordance with the Single Audit Act, as amended by the Single Audit Act Amendments of 1996. The Single Audit Act, as amended, requires us to determine whether

Department of Employment Security Organization Chart



- the state complied with rules and regulations that may have a material effect on each major federal financial assistance program, and
- the state has internal control to provide reasonable assurance that it is managing its major federal award programs in compliance with applicable laws and regulations.

We determined the following areas within the Department of Employment Security were material to the CAFR: the Unemployment Trust Fund, the Employment Service Program, and the Unemployment Insurance Program. We determined that the Employment Service Program, the Unemployment Insurance Program, and the Trade Adjustment Assistance Program were material to the Single Audit Report.

To address the objectives of the audit of the CAFR, as they pertain to the Unemployment Trust Fund, we interviewed key department employees, reviewed applicable policies and procedures, and tested representative samples of transactions, as appropriate. Our testwork on the Unemployment Trust Fund included tests of eligibility of unemployment recipients, tests of the calculation of unemployment taxes paid by employers, tests of receivable balances, confirmation of cash balances and interstate benefits receivable, and other analytical procedures to determine if the financial statements are fairly presented. Our work on the Unemployment Trust Fund was an integral part of the CAFR audit, and the financial statements of the trust and agency funds are presented in the CAFR.

To address the objectives of the audit of the CAFR and the Single Audit Report, as they pertain to the Employment Service Program, the Unemployment Insurance Program, and the Trade Adjustment Assistance Program, we interviewed key department employees, reviewed applicable policies and procedures, and tested representative samples of transactions.

We have audited the general-purpose financial statements of the State of Tennessee for the year ended June 30, 1998, and have issued our report thereon dated January 25, 1999. The opinion on the financial statements is qualified. Because of the unprecedented nature of the Year 2000 issue, its effects and the success of related remediation efforts will not be fully determinable until the Year 2000 and thereafter. The Tennessee Single Audit Report for the year ended June 30, 1998, will include our reports on the schedule of expenditures of federal awards and on internal control and compliance with laws and regulations.

We determined that the department did not comply with cash management objectives, as discussed in the finding. In addition to the finding, other minor weaknesses came to our attention and have been reported to management in a separate letter.

The department did not comply with cash management objectives

Finding

The Department of Employment Security's cash drawdown method did not comply with the cash management requirements of Office of Management and Budget Circular A-102 and U.S. Department of Treasury regulations. Part 31, Section 205.20 of the Code of Federal Regulations states that the timing and amount of cash advances shall be as close as is administratively feasible to the actual cash outlay by the state.

Treasury regulations, which implement the Cash Management Improvement Act (CMIA), require state recipients to enter into agreements prescribing specific methods of drawing down federal funds for selected programs. The cash management agreement between the State of Tennessee and the U.S. Department of Treasury calls for Unemployment Insurance Administrative Costs to be drawn so that the department receives one-sixth of the quarterly administrative allowance for every pay period. This drawdown method was based on the assumption that the department would disburse the entire pro rata amount of its allowance each pay period. The Department of Employment Security complied with the method of drawing and receiving funds; however, it did not disburse all of the funds received in a timely manner. As a result, the department had accumulated unspent federal funds of \$5,614,690.50 at June 30, 1998. Although the contractual provisions of the cash management agreement were followed, the objectives of the cash management requirements were not accomplished.

Recommendation

The drawdown provisions for the Unemployment Insurance Administrative Costs in the cash management agreement between the U.S. Department of Treasury and the State of Tennessee should be amended to ensure that the timing and amount of drawdowns are based on actual cash outlays, rather than on a fixed percentage of the administrative allowance.

Management's Comment

We concur with your audit finding for the year ended June 30, 1998, that the department did not comply with cash management objectives. As stated in your finding, although the contractual provisions of the cash management agreement were followed, the objectives of the cash management requirements were not accomplished.

As of January 1, 1999, the CMIA agreement has been amended to reflect a change in the method of drawing down federal funds from a technique of Fixed Administrative Allowance (Semi-Monthly-Quarterly Administrative Allowance) to one of Cost Allocation (Actual Costs-Estimated Allocation – Semi-Monthly). This will result in the drawdown of actual costs from federal cost accounting system on a monthly basis.

PAYROLL

The objectives of our review of the department's payroll controls and procedures were to determine whether

- payroll (wages, salaries, and benefits) disbursements were made only for work authorized and performed;
- payroll was computed using rates and other factors in accordance with contracts and relevant laws and regulations; and
- payroll and related liabilities were recorded correctly as to amount and period, and distributed properly by account, fund, and budget category.

We interviewed key personnel to gain an understanding of the department's procedures and controls over payroll. We also tested a nonstatistical sample of payroll. We had no findings related to payroll.

INTERSTATE BENEFIT RECEIVABLE

The objectives of our review of interstate benefits controls and procedures were to determine whether

- revenue amounts uncollected and presented as receivable at the end of the fiscal period were valid; and
- procedures to collect past due accounts were adequate.

We interviewed key personnel to gain an understanding of the department's procedures and controls over interstate benefits. We also tested a nonstatistical sample of interstate benefits. We had no findings related to interstate benefits.

EMPLOYER TAX RECEIVABLE

The objectives of our review of the controls and procedures for employer tax receivables were to determine whether

- revenue amounts uncollected and presented as receivable at the end of the fiscal period were valid;
- procedures to collect past due accounts were adequate; and
- an adequate allowance for uncollectible accounts had been established.

We interviewed key personnel to gain an understanding of the department's procedures and controls over employer tax receivables. We tested a nonstatistical sample of receivables. We

also tested receivables of \$25,000 or greater. We had no findings related to employer tax receivable; however, other minor weaknesses came to our attention and have been reported to management in a separate letter.

BENEFIT OVERPAYMENT RECEIVABLE

The objectives of our review of the controls and procedures for benefit overpayment receivables were to determine whether

- revenue amounts uncollected and presented as receivable at the end of the fiscal period were valid;
- procedures to collect past due accounts were adequate; and
- an adequate allowance for uncollectible accounts had been established.

We interviewed key personnel to gain an understanding of the department's procedures and controls over benefit overpayment receivables. We also tested a nonstatistical sample of benefit overpayment receivables. We had no findings related to benefit overpayment receivable.

REVENUE

The objectives of our review of revenue controls and procedures were to determine whether

- revenues that were available and measurable in the fiscal period were recorded;
- revenues or fees were billed or charged and recorded at the correct amount; and
- revenues were properly classified by fund type in the financial statements and related disclosures were adequate.

We interviewed key personnel to gain an understanding of the department's procedures and controls over revenues. We also tested a nonstatistical sample of revenues. We had no findings related to revenue; however, other minor weaknesses came to our attention and have been reported to management in a separate letter.

UNEMPLOYMENT TAX

The objectives of our review of unemployment tax controls and procedures were to determine whether

- the department had complied with applicable provisions of *Tennessee Code Annotated*;
- employer taxes were properly computed and transferred to the trust fund;
- refunds issued to employers were reasonable and adequately supported; and
- penalties and interest were charged when applicable and accounted for properly.

We interviewed key personnel to gain an understanding of the department's procedures and controls over unemployment tax. We also tested nonstatistical samples of taxpayer accounts and refunds to taxpayers. We had no findings related to unemployment tax.

UNEMPLOYMENT BENEFITS

The objectives of our review of unemployment benefits controls and procedures were to determine whether

- the department had complied with applicable provisions of *Tennessee Code Annotated*;
- benefit amounts were properly computed; and
- only eligible recipients received benefits.

We interviewed key personnel to gain an understanding of the department's procedures and controls over unemployment benefits. We also tested a nonstatistical sample of benefit recipients. We had no findings related to unemployment benefits.

DEPARTMENT OF FINANCE AND ADMINISTRATION POLICY 20, “RECORDING OF FEDERAL GRANT EXPENDITURES AND REVENUES”

Department of Finance and Administration Policy 20 requires that state departments whose financial records are maintained on the State of Tennessee Accounting and Reporting System (STARS) fully utilize the STARS Grant Module to record the receipt and expenditure of all federal funds. The Department of Employment Security has received an exception to this policy. Because of the unique nature of the department's grants, a cost-accounting system based on time distribution is used. STARS does not have the ability to distribute indirect costs to programs based on the percentage of time charged to each program.

PRIOR AUDIT FINDINGS

There were no findings in the prior audit report.

OBSERVATIONS AND COMMENTS

TITLE VI OF THE CIVIL RIGHTS ACT OF 1964

Tennessee Code Annotated, Section 4-21-901, requires each state governmental entity subject to the requirements of Title VI of the Civil Rights Act of 1964 to submit an annual Title VI compliance report and implementation plan to the Department of Audit by June 30, 1994, and each June 30 thereafter. For the year ending June 30, 1998, the Department of Employment Security filed its compliance report and implementation plan on June 29, 1998.

Title VI of the Civil Rights Act of 1964 is a federal law. The act requires all state agencies receiving federal money to develop and implement plans to ensure that no person shall, on the grounds of race, color, or origin, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity receiving federal funds.

The State Planning Office in the Executive Department was assigned the responsibility of serving as the monitoring agency for Title VI compliance, and copies of the required reports were filed with the State Planning Office for evaluation and comment. However, the State Planning Office has been abolished. The Office of the Governor has not designated a new monitoring agency for the Executive Branch.

A summary of the dates state agencies filed their annual Title VI compliance reports and implementation plans is presented in the special report *Submission of Title VI Implementation Plans*, issued annually by the Comptroller of the Treasury.

APPENDIX

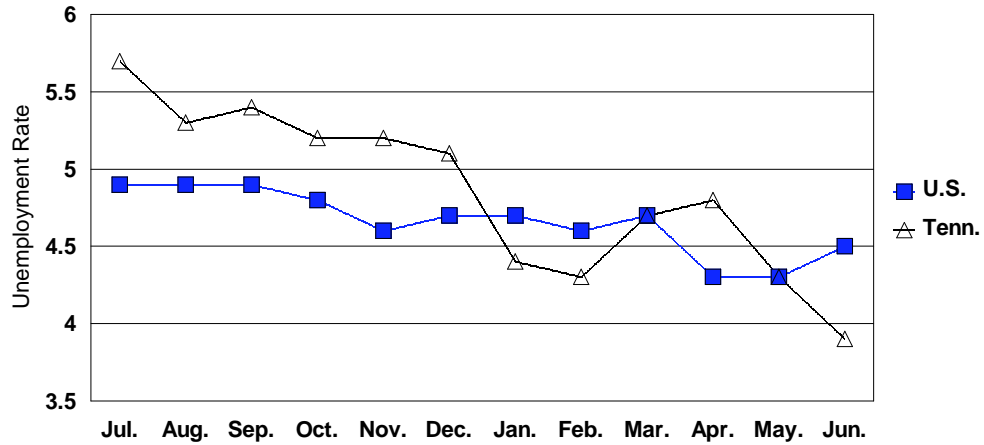
DIVISIONS AND ALLOTMENT CODES

Department of Employment Security divisions and allotment codes:

331.01 Division of Administration
333.03 Deferred Revenue
333.09 Trust Fund

Unemployment Rates - U.S. & Tennessee

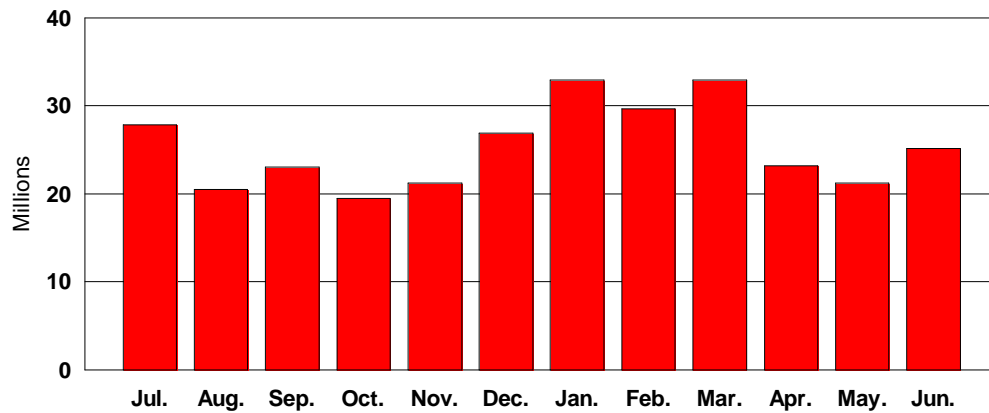
Seasonally Adjusted, July 1997 to June 1998



Source: Department of Employment Security

Unemployment Insurance Claims Paid

Fiscal Year Ended June 30, 1998



Source: Department of Employment Security